UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company, Complainant v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator Corporation And the California Power Exchange, Respondents	)	Docket No. EL00-95-075
Investigation of Practices of the California Independent System Operator and the California Power Exchange	)	Docket No. EL00-98-063
Public Utilities Commission of the State of California, Complainant v. Sellers of Long Term Contracts to the California Department of Water Resources, Respondents	)	Docket Nos. EL02-60-003 EL02-62-003 (Consolidated)

SUPPLEMENTAL SUBMISSION OF EVIDENCE AND REQUEST FOR RELIEF OF THE CALIFORNIA ELECTRICITY OVERSIGHT BOARD AND THE CALIFORNIA PUBLIC UTILITIES COMMISSION

Pursuant to the Commission's November 20, 2002 "Order on Motion for Discovery Order"[1] in *San Diego Gas & Electric Co., et al,* Docket No. EL00-95-075, *et al.*, as clarified by the Commission's February 10, 2003 Order[2] (the "100-Day

[1] *San Diego Gas & Electric Co., et al.,* 101 FERC ¶ 61,186 (2002) ("November 20 Order").

[2] *San Diego Gas & Electric Co., et al.,* 102 FERC ¶ 61,164 (2003) ("February 10 Order").

Proceeding"), the California Electricity Oversight Board and the California Public Utilities Commission (collectively the "California Agencies") hereby jointly submit this filing of additional evidence to supplement the record in the 100-Day Proceeding and in *California Public Utilities Commission v. Sellers of Long Term Contracts to the California Department of Water Resources*, EL02-60 and EL02-62 (consolidated) ("Long Term Contract Proceeding"). This filing consists of this pleading, the sworn testimony of Steven Stoft, Ph.D., the attached Executive Summary, the attached Index of Relevant Material, and relevant testimony and exhibits previously offered in the Long Term Contract Proceeding.

The California Agencies offer this filing as a supplement to the joint submission filed by the California Parties, including the California Agencies, under separate cover in the 100-Day Proceeding, which submission is incorporated by reference herein.

This supplemental filing addresses the relevance to the issues in the Long Term Contract Proceeding of certain evidence that the California Parties have adduced in the 100-Day Proceeding. Specifically, the Commission now has concrete proof of widespread and rampant market abuse and manipulation by sellers in the California spot markets during the period January 1, 2000 through June 20, 2001. Heretofore barred from gathering or presenting evidence of this type in the Long Term Contract Proceeding, the California Agencies have argued that market conditions were such that conduct of this type must have occurred, and that the extraordinarily high forward prices at the time were substantially enhanced by those abuses of the spot markets and the knowledge that such abuses would likely occur in 2001 and 2002, given the expectation of continued tight supply. Respondents and their experts offered a contrary view, arguing in essence

that California electricity prices rose due to so-called fundamentals alone, and were not substantially enhanced by market abuse, hence there was no reason for forward expectations based on current prices to be deemed affected by market abuse. Commission Staff, in turn, took the view that the California Agencies had not produced sufficient evidence to prevail, and therefore should not prevail "unless a showing can be made that the prices were the result of market power and/or market manipulation, issues that are not within the scope of this proceeding." Staff In. Br. at 49.

As is now detailed in this filing, even with limited discovery and no opportunity for cross-examination, it is now clear that the exercise of market power and market manipulation was rampant, was aimed precisely at conditioning expectations concerning forward prices, and clearly had that effect. Moreover, the glimpse behind the curtain that has now been provided makes clear that many of the Respondents in the Long Term Contract Proceeding were themselves engaged in the type of misconduct that helped cause and exacerbate the California energy crisis. The notion that any hugely profitable contracts obtained by these Sellers as a result of the crisis should now be blessed by the Commission has become simply untenable and unimaginable.

I. BACKGROUND

The Commission established the 100-Day Discovery Period through its November 20, 2002 Order, which was issued in response to a motion filed by the California Parties, including California Agencies, to implement the August 21, 2002 order of the United States Court of Appeals for the Ninth Circuit. Among other things,[3]

[3] The February 10 Order principally responded to concerns that confining the newly adduced evidence to a single submission as originally contemplated by the November 20 Order, without the ability to file reply comments or cross examine witnesses, would infringe the parties' due process rights.

the February 10 Order offered guidance on the format for the evidence to be adduced in the 100-Day Proceeding by February 28, 2003.[4] In particular, the February 10 Order requires that an "index of material should be provided for [EL00-95 *et al.*], and a separate index should be provided for *each other pending or proposed proceeding for which the filer claims its submission is relevant.*"[5] On its face, this broadly worded requirement appears to encompass the Long Term Contract Proceeding as that proceeding remains pending and the California Agencies believe that evidence of market power and market manipulation is relevant therein.

At the time the February 10 Order issued, the record in the Long Term Contract Proceeding was closed, post-trial briefing was completed, and the entire record had been certified to the Commission. The fundamental dispute in the Long Term Contract Proceeding centers on the cause of the rise and fall in forward prices in the first half of 2001, which prices are embedded in the disputed contracts. The California Agencies contend that market power and manipulation contributed significantly to inflating spot prices during the power crisis and that expectations of such continued anti-competitive conduct (including withholding in tight supply conditions) operated to inflate the forward bilateral prices upon which the challenged contracts were based. If substantial withholding occurred in California when markets were tight, it follows that forward prices would be affected by expectations that similar withholding would occur whenever markets were tight in California, and, moreover, any seller who helped cause the crisis would have a special basis for predicting such behavior in the future. Respondents

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[4] By Order issued on February 24, 2003, the Commission extended this deadline to March 3, 2003 due to the recent winter storm in Washington, D.C.

[5] February 10 Order, slip op. at 6 (emphasis added).

counter that the fluctuations in forward prices were all due to changing expectations of market fundamentals (the relationship between supply and demand).

In the Long Term Contract Proceeding, the California Agencies attempted to discover and present evidence tending to show that (1) market power was indeed exercised and that market manipulation was occurring; (2) each Seller in the Long Term Contract Proceeding was itself exercising market power and/or otherwise manipulating the market prices upward; and (3) each Seller had a basis at least until the end of May, or early June, 2001, for believing that it or others would be able to continue to exercise market power and otherwise manipulate the markets. To this end, the California Agencies attempted to elicit or present the following proof:

- Through data requests on the Sellers, the CEOB sought, among other things, information regarding Seller knowledge or exercise of market power and/or manipulation. (*See, e.g.*, First Data Requests of the California Electricity Oversight Board, Requests 16, 51-67.)

- The CEOB filed applications for the issuance of subpoenas for each Seller seeking deposition testimony regarding, among other things, "the participants' expectations as to the duration of dysfunctions in the California ISO and PX markets," and production and designation of a person to testify regarding market power and/or manipulation in the California ISO and PX markets, and specifically the extent to which, if any, the Seller itself demonstrated or possessed an ability to contribute to or exacerbate the dysfunctions in the California ISO and PX markets including attempts to withhold capacity or supplies from the electricity or natural gas markets (either physically or financially). (CEOB's Application for Issuance of Subpoenas, Docket Nos. EL02-60-003 & EL02-62-003 (Sept. 29, 2002).)

- The California Agencies submitted testimony introducing studies and expert opinion to demonstrate the existence and impact of market power on the spot and forward markets. Generally, the California Agencies offered the following:

    -- Direct Testimony of Steven Stoft, Ph. D., on how the opportunity to exercise market power both created the energy crisis and affected forward market expectations of continued market power and withholding (Ex. CAL-90 at, *e.g.*,, 11:9–15:5; 46:3-47:2);

-- Direct Testimony of Miles Bidwell, Ph.D., on the evidence of market power among sellers in California's electricity markets in 2000 and 2001 (Ex. 80);

-- Rebuttal Testimony of Steven Stoft, on the effect of market power on price (Ex. CAL-154 at, *e.g.*, 21:19-22:22; 79:6-83:21).

At each turn, however, the Presiding Administrative Law Judge foreclosed the California Agencies' pursuit of any evidence or claim based on market abuse and associated withholding, first denying the California Agencies' discovery requests and then striking the expert testimony and studies on market power. (Sept. 30, 2002 Pre-hrg. Tr. 198:6-199:14; Nov. 1, 2002 Order Granting in Part and Denying in Part Cross Motions to Strike (Docket Nos. EL02-60-003 and EL02-62-003).)

The denial of the ability to conduct discovery – or even to submit into the record undisputed evidence of market power already in California Agencies' possession – placed CEOB and CPUC in the untenable position of having to sit idly by while the Sellers pointed to market fundamentals as the sole cause of the dysfunctional market's inflation and deflation. The effect of hamstringing the California Agencies in this way is reflected in some of the arguments raised by the counter-parties in pre- and post-trial briefs, where the California Agencies are repeatedly chastised for failing to provide evidence countering the Respondents' asserted proof that market fundamentals alone drove the forward market prices. (*See, e.g.*, Staff Pre-Trial Brief at 21 ("They totally ignore their heavy burden to provide creditable evidence to isolate the impact of the fundamentals from that of the dysfunctions they claim affected forward prices"); Indicated Respondents' Joint Pre-Trial Brief at 5 ("They do not offer any affirmative case attempting to show that forward prices were *not* explained by fundamentals.") (emphasis in original); Indicated Respondents' Initial Brief at 16 ("In his direct testimony, Dr. Stoft

cited no specific factors – whether putative dysfunctions or market fundamentals – that would explain the price changes occurring in his critical two-week price period.").) Staff's Initial Brief candidly identified the stumbling block facing the California Agencies when Staff argued that the State was the party responsible for the contracts: "it is those choices that the State of California should have to live with, unless a showing can be made that the prices were the result of market power and/or market manipulation." (Staff's Initial (Post-Hearing) Brief at 67.)

Denied the opportunity to discover evidence, present undisputed evidence already in their possession or cross examine witnesses on market abuse, the California Agencies argued in their post-hearing briefs that in light of those rulings by the Presiding Judge the Commission must either:

- Presume that each contracting seller committed market abuse in a manner that contributed to the dysfunction in the spot market and had a basis for expecting such abuse of that type would continue such that prices in the forward contracts include a premium incorporating the spot market dysfunction; or
- Remand for discovery and hearing on the issue of market abuse.[6]

The February 10 Order raises the question whether the Commission intended to effectively grant California Agencies' request for remand in the Long Term Contract Proceeding in this unorthodox manner, via an order issued not in Dockets EL02-60 or EL02-62, but in two other proceedings. If so, this approach leaves the California Agencies in an awkward position. On the one hand, they applaud the Commission's apparent acknowledgement that market power and market manipulation evidence is

[6] *See* Post Hearing Brief on Behalf of the California Electricity Oversight Board and California Public Utilities Commission, EL02-60-003 and EL02-62-003 (consolidated) at 115 (Jan. 10, 2003); Reply Brief on Behalf of the California Electricity Oversight Board and California Public Utilities Commission, EL02-60-003 and EL02-62-003 (consolidated) at 28 (Jan. 27, 2003).

relevant and will be considered in the Long Term Contract Proceeding. On the other hand, the California Agencies find the procedures put in place by the February 10 Order woefully inadequate because they have been afforded only 18 days in which to conduct discovery and present their market power/market manipulation case as it bears in particular on the Long Term Contract Proceeding, without the benefit of depositions and cross examination.[7]

Because of this peculiar outcome, the California Agencies on February 20, 2003 filed a motion for clarification or in the alternative rehearing with respect to the ramifications of the February 10 Order on the Long Term Contract Proceeding.[8] An order on that Motion has not yet issued; thus, to protect their interests, the California Agencies are submitting in Dockets EL00-95 *et al*., and in EL02-60 and EL02-62 the market power testimony and exhibits they have been able to produce in the abbreviated timeframe since the February 10 Order. We agree that all of the evidence submitted

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[7] As explained in Joint Expedited Request for Clarification or, Alternatively, Rehearing, of the California Electricity Oversight Board and the California Public Utilities Commission, Docket Nos. EL00-95-075 *et al.*, at 7 (Feb. 20, 2003), the California Agencies could not have reasonably anticipated any intent by the Commission to substitute the 100-Day Discovery Period for full discovery rights in the Long Term Contract Proceeding. In their response to the California Agencies' Request for Clarification, the Respondents assert the bizarre argument, for which they cite absolutely no precedent, that the California Agencies have waived their rights to seek inclusion of market power evidence in the Long Term Contract Proceeding by failing to take an interlocutory appeal of the Presiding Judge's rulings. *See* Sellers' Joint Answer Regarding Request for Clarification or Alternatively Rehearing at 9, Docket Nos. EL00-95-075 *et al.* (Feb. 27, 2003). In pressing this point, Respondents completely fail to address Commission Rule 509 which expressly preserves a participant's rights to raise the validity of any ruling excluding evidence on exceptions to the Initial Decision. 18 C.F.R. § 385.509(b)(3). If the Commission were ever to adopt this argument, it would in effect place every litigant before the Commission in the position of having to take an interlocutory appeal on every significant discovery and evidentiary ruling made before the issuance of the initial decision or risk waiver. Making interlocutory rulings mandatory would certainly render meaningless the rule's allowance (but not requirement) of such in "extraordinary circumstances." 18 C.F.R. § 385.715.

[8] *See supra* note 7.

herewith and as part of the California Parties' joint submission should be made part of the record in the Long Term Contract Proceeding in the manner set forth in the February 10 Order. Nevertheless, the procedures put in place by the February 10 Order as applied to the Long Term Contract Proceeding in no way provide a proper substitute for the rights that the Presiding Judge denied the California Agencies in the Long Term Contract Proceeding given the unique factual proposition critical to that proceeding: namely, that market power and market manipulation in the spot market affected prices in the long-term forward markets.

Without more, simply allowing the inclusion of the market power/market manipulation evidence adduced in the 100-Day Proceeding into the record for the Long Term Contract Proceeding will result in significant prejudice to the California Agencies in three respects. [9]

First, the Presiding Judge's market power rulings placed the California Agencies' witnesses in the situation of having to present their testimony and to respond to cross-examination under instructions that even the mere reference to "market power" was taboo. (*See, e.g.* EL02-60 Tr. at 944 (Dr. Stoft referring to the "dysfunction of a type that I will not name," *i.e.* market power).) This significantly constrained the development of a complete record.

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[9] That being so, the Commission's apparent decision at this late date to allow the California Agencies to fill the record in the Long Term Contract Proceeding case via the wholesale importation of the market power and market manipulation evidence from other proceedings that focused on different aspects of these issues does not satisfy the California Agencies' right to a full and fair opportunity to present such market power and market manipulation evidence. *See Exxon Corp. v. Secretary of Transp.*, 978 F.Supp. 946, 954, fn. 7 (E.D.Wash. 1997) (essential element of due process is meaningful opportunity to be heard); *Bowman Transp., Inc. v. Arkansas Best Freight Systems, Inc.*, 419 U.S. 284, 288, fn. 4 (1974) (same).

Second, and even more importantly, the California Agencies were completely barred from cross-examining the Respondents' experts on the basis of precisely the type of evidence (*i.e.*, significant market power and market manipulation) that has now been produced. Pouring evidence into the file after the record is closed hardly makes up for the lost opportunity to use the market power evidence to take apart the Respondents' expert case with their own admissions. This is especially so here where the thrust of the Respondents' experts case was that fundamentals alone explain the prices in both the spot and forward markets. Nor were the California Agencies the only party so constrained. The Presiding Judge's rulings required the Staff to submit testimony that did not analyze the impact of market power on the forward markets and forced the Staff to repeatedly caveat their testimony concerning the significance of market power to the outcome of the Long Term Contract Proceeding. (*See* Ex. CSA-2; Staff In. Br. (Comm.) at 39.)

Third, given its focus entirely on spot market issues, the discovery performed in the 100-Day Proceeding has not fully pursued the connection between the spot market misconduct and the forward markets. To the extent that any Seller still persists in the fiction that the prospect of continued market power in the spot market somehow had no effect on forward prices, the California Agencies should be allowed to conduct further discovery and analysis on at least the following issues:

- Any seller's expectation that future spot market prices would be affected by its own or any other seller's exercise of market power or market manipulation;
- Any seller's understanding that current spot market prices were affected by its own or any other seller's exercise of market power; and
- Any seller's financial incentive to inflate forward market prices through manipulation of energy markets or exercise of market power.

There has been neither the reason nor the adequate opportunity to develop these issues in either EL00-95 *et al.* and its associated 100-Day Discovery Period. Moreover, as evident from the Response of Allegheny Energy Supply Company to the Expedited Motion for Clarification of CEOB and CPUC (filed February 28, 2003), certain Sellers are claiming that they are not subject to discovery on market power issues in the 100-Day Proceeding because they are no longer participants therein, leaving the California Agencies with no ability to discern the extent of knowledge of or participation in market abuse by those particular Sellers.

I. SUMMARY OF SUPPLEMENTAL EVIDENCE.

Notwithstanding the time constraints and the limitations in the scope of the discovery pursued in the 100-Day Proceeding, the California Agencies offer the testimony of Steven E. Stoft, Ph.D (Ex. CSA-2) to explain how the substantial volume of newly revealed evidence regarding the exercise of market power and market manipulation in the California spot markets, especially when viewed in the context of what was already known, bears on the assessment of the long-term forward markets in California during the energy crisis of 2000-2001 and more specifically, how it further corroborates the testimony Dr. Stoft previously offered in the Long Term Contract Proceeding. (*See* Ex. CSA-1 at 2 (Stoft direct) & 96 (Stoft rebuttal).)

A. Dr. Stoft's Background.

Dr. Stoft, who has a Ph.D. in Economics (1982) and a B.S. in Engineering Mathematics (1969), both from the University of California at Berkeley, is a professional economist with fifteen years' experience in the study of economic issues relating to electricity products and markets. He is the author of *Power System Economics:*

Designing Markets for Electricity (2002, IEEE Press), a comprehensive treatise on the theory and practice of power market design. He has also published dozens of scholarly papers and reports on issues related to electricity markets, a list of which is included with his Curriculum Vitae. (*See* Ex. CSA-1 at 81.)

Dr. Stoft has been invited to speak on electricity market issues before the National Science Foundation, the World Bank, FERC, the Edison Electricity Institute, the U.S. Department of Energy and others. He has held appointments with FERC's Office of Economic Policy, where he worked with Dick O'Neill's consultants on advanced market-design issues and reviewed the NYIOS's startup Filing, and at the University of California Energy Institute. In addition, as a self-employed professional consultant, he has advised public utilities, private power companies, and governmental entities on electricity market issues. Since September 1999, he has also been a paid advisor to PJM's Market Monitoring Unit.

B. The Purpose of Dr. Stoft's Testimony.

In his prior testimony, which is reproduced as part of Exhibit No. CSA-1 here, Dr. Stoft explained in detail that dysfunctions in the California spot markets significantly inflated forward market prices for electricity in California for deliveries in 2001, 2002 and 2003. Often, market power played a major role in the dysfunctions he analyzed, but because of the prohibition in the Long Term Contract Proceeding against discussing the two central categories of dysfunction, market power and market manipulation, and because discovery of tangible evidence of such abuses was barred in that proceeding, Dr. Stoft was unable to provide as compelling an explanation as can now be presented. Dr. Stoft's new testimony accordingly uses the new evidence adduced by the California

Parties in the 100-Day Proceeding to demonstrate that the exercise of market power and other market manipulation by sellers in those spot markets played a principal role in inflating forward market prices.

C. The Structure of Dr. Stoft's testimony.

Dr. Stoft's testimony is structured in four parts. First, he uses Reliant's documented market misconduct in June 2000 to show that the theory of how spot market dysfunction adversely affects forward prices is not only correct, but was actually put into practice precisely for the purposes of raising forward prices in the forward market. The evidence also demonstrates that traders understood this relationship and, understanding it, were motivated to take advantage of it. Consequently, as the Commission has now recognized, the desire to adversely affect forward prices actually increased the dysfunction in the spot market.

Next, Dr. Stoft uses new evidence provided by Mirant to explain how tight supply-demand fundamentals enhance market power. He then use this newly documented property of market power to demonstrate the contradictions in a fundamentals-only explanation of the high Q3:2001 forward prices paid in March 2001, the heart of the long-term contracting period.

Dr. Stoft next uses new evidence and testimony from the 100-Day Proceeding to show that the exercise of market power in, and other manipulation of, the California spot markets during the California energy crisis of 2000-2001 were extremely widespread and not limited to this one substantial case involving Reliant in June 2000.

Finally, he explains the import of this new evidence for the Commission's determination of the threshold issue in the Long Term Contract Proceeding, especially when analyzed in the context of what was previously known: such dysfunction in the California spot markets adversely affected the long-term bilateral markets, and the effect warrants modification of the contracts at issue in that proceeding.

D. A Summary of Dr. Stoft's Testimony.

Direct statements from California generators, uncovered in the 100-Day Proceeding and the Staff's investigation, Docket No. PA02-2, and empirical analysis of California generators' bidding behavior developed in the 100-Day Proceeding lead to the inescapable conclusion that spot market prices in California during the energy crisis of 2000-2001 were often raised far above the competitive level by market manipulation and the exercise of market power. That evidence corroborates the opinion, expressed by a large majority of economists who have analyzed the issue, that the exercise of market power inflated spot market prices during the crisis by a substantial margin. The most recent issue of the American Economic Review attributed 59% of the price increase during the Summer of 2000 to market power. New evidence from the 100-Days Proceeding demonstrates that this pattern continued into the Spring of 2001.

In the Long Term Contract Proceeding, the examination of the causes of the undisputed rise and fall of spot prices became an important point of contention in explaining the behavior of forward prices. Dr. Stoft testified that the rise of spot prices was caused in substantial part by the exercise of market power, that forward prices rose on the basis of expectations that future spot prices would be similarly enhanced in tight markets, and that the fall in both spot and forward prices that occurred in the Spring of

2001, including the collapse in late May, was the result, in substantial part, of the realization that the exercise of market power would be more difficult in the loosening market conditions and with a new regulatory "cop on the block." (*See, e.g.*, Ex. CSA-1 (EL02-60 & -62, Exs. CAL-90 at 30-40, CAL-154 at 12-26, 65-78, Tr. at 969:12 – 970:1).) Respondents' opposing experts, especially Drs. Hogan and Harvey, presented a starkly contrary view, under which the rise and fall of electricity prices was fully explained by market fundamentals of actual and expected supply and demand, with the limited exception, perhaps, of a credit dysfunction in the ISO market. (*See, e.g.*, Docket Nos. EL02-60 & -62, Exs. MSC-7 at 8:12 – 9:12, MSC-16 at 1:8 – 4:9).)

Thanks to the evidence that has been adduced in the 100-Day Proceeding, we now know with certainty that Respondents' experts were clearly wrong in their efforts to maintain the fiction that actual and expected fundamentals alone drove spot and forward prices. Recently released tape recordings show clearly that, in June 2000, Reliant intentionally affected the prices in the entire market by physically withholding supply and manipulated the spot markets and forward markets by disseminating false information to brokers for the express purpose of inflating spot prices at the time and forward prices for Q3:2001 for all sellers. The gambit was successful, and the other evidence reviewed by Dr. Stoft makes clear that seller misconduct was not limited to this one instance of Reliant's misconduct in June 2000.

The new evidence also reinforces – from the mouth of one of these very sellers – the point that tighter markets enhance the exercise of market power, and that sellers know and expect this. Diagrams by Mirant, which show the exercise of market power in the California market, also show that it increases from non-existent to extreme as the market

goes from moderate supply-demand conditions to extremely tight conditions. This refutes the assertion by Drs. Harvey and Hogan that dysfunction does not increase as the market tightens. This linkage is corroborated by a variety of other authorities from the Commission to California's market monitors.

Empirical studies corroborate precisely what economic theory would predict: that the problem of market power in the California markets gets *worse*, not better, as economic fundamentals get tighter. Indeed, as it became clear in the Winter of 2000 – 2001 that substantial volumes of forward purchases would be made in the California markets, sellers with market power and the ability to sell forward had every incentive to boost forward prices, as Reliant did, by exercising that market power in the spot market. The Commission itself recognized this danger in its December 15, 2000 order. And that order did nothing to cure the problem of such market abuse: market observers and market participants predicted its failure before the order issued, and continued to believe after the order issued that it had not solved the California market's problems.

The new evidence thus directly and irrefutably supports the proposition that dysfunctions in the California market caused not only the price rise in the Spring and Summer of 2000, but also caused the sustained high levels of prices in the Spring of 2001; and the collapse of spot and forward prices in April-June of 2001 (including the "double crash" that began in late May) was due in substantial part to changes in sellers' ability to exercise market power and to changing expectations about future exercises of market power. The evidence now made available confirms that this dysfunction deserves the name that heretofore has been taboo in the Long Term Contract Proceeding: seller misconduct in the form of market manipulation and the exercise of market power.

Finally, the evidence establishes that many of those who contracted with CDWR themselves engaged in market misconduct. Such evidence directly affects the public interest implications posed by the requests to reform the subject long-term contracts. This is especially so of Dynegy and Mirant, two of the generators. There is simply no legitimate public interest that is adversely affected by requiring cost-based justification from a seller whose own misconduct contributed to the very crisis that led to the long-term contracts. To the contrary, it is fair to say that virtually all economists would agree that the public interest would be furthered by requiring such justification by such a seller.

III. MODIFICATION OF THE CONTRACTS REMAINING IN DISPUTE IN THE LONG TERM CONTRACT PROCEEDING IS PARTICULARLY APPROPRIATE BECAUSE EACH OF THE REMAINING RESPONDENTS IN THAT DOCKET CAUSED OR CONTRIBUTED TO THE CALIFORNIA ELECTRICITY CRISIS THROUGH THEIR MARKET MISCONDUCT.

Waving the "sanctity of contract" banner, the Respondents in the Long Term Contract Proceeding argue that the Commission should not provide any relief in that proceeding because doing so will undermine forward power markets and investment in new generation. They also portray themselves as much victims of the California energy crisis as CDWR in that they were forced to purchase high priced power in the California markets in order to sell it at a significant discount to CDWR under the terms of their long-term contracts.

The evidence of the participation of most, if not all, of the Respondents in causing or contributing to the California energy crisis, however, refutes both Respondents' policy arguments against reformation and their "clean hands" defense. If a seller in a long-term electricity contract caused or contributed to the meltdown of the California markets, that seller has no standing to dispute the appropriateness of contract reformation that denies

the seller the windfall profits they seek to receive from the unjust and unreasonable prices embedded in the contract.

Moreover, and more importantly, reforming the contract of a seller with unclean hands should have no detrimental effect on the forward markets as a whole. We have previously argued that the Commission will create no negative precedent, and, in fact, will be upholding its responsibilities under the FPA, if it announces a rule that it will reform the rates of any long-term contract entered into during an announced period of market dysfunction to ensure that they are just and reasonable while at the same time sufficient to cover costs and provide a reasonable rate of return for any innocent seller. Even if it does not agree with this argument, however, the Commission certainly must agree that reforming the rates in a long term contract of a seller that itself caused or contributed to the market dysfunction would be in the public interest. In this regard, under whatever construction of the *Mobile-Sierra* doctrine the Commission settles upon, it must be in the "public interest" to ensure that any seller who causes or contributes to a market meltdown of the sort experienced in California should not be allowed to maintain the windfall benefits of a long term contract entered into as a result of that meltdown. The electricity and investment markets will receive the proper signals from such a rule. The markets will know that the "cop is on the beat" ensuring that the electricity markets are competitive and that the exercise of market power and market manipulation will not be tolerated.

The California Parties' joint submission demonstrates that several, if not all, of the Respondents remaining in the Long Term Contract Proceeding, in fact, caused or at

least contributed to the California energy crisis through the exercise of market power or other manipulative conduct. The following summary highlights this evidence.

Dynegy

- Throughout the energy crisis, Dynegy regularly and systematically exercised market power by withholding (both physically and financially) significant quantities of power from the spot markets. In fact, even accepting the forced outages reported by Dynegy, which are subject to significant challenge as discussed below, Dynegy, regularly withheld up to 40% of its on-peak capacity from the market during the period January 1, 2000 through February 2001, at which point it executed its long-term contract with CDWR. (Ex. CA-5 at 16, Fig. 5 & 93, Fig. 20; Ex. CA-7 at 64-78.)

- Dynegy financially withheld capacity from the market by regularly bidding its units at far in excess of their marginal cost and the market clearing price and employing other non-competitive bidding strategies. For example, during the period June through September 2000, Dynegy regularly used hockey stick bidding strategies, which produced very wide and non-competitive bid spans ranging to over $300 for certain units. In addition, Dynegy regularly spiked its bids for certain units during system emergencies. (Ex. CA-7 at 64-78.)

- Dynegy physically withheld generation capacity from the market by, among other things, declaring forced outages for certain of its units when in fact the units were operable and could have run above marginal cost. For example, during the period August 30 through September 3, 2000, Dynegy reported to CAISO that the El Segundo Unit 1 was on scheduled outage to repair a generator brush rigging. Dynegy's internal records, however, show that the unit was, in fact, down for economic reasons. (Ex. CA-9 at 23.) In addition during the period November 19 through December 5, 2000, Dynegy declared both El Segundo Units 1 and 2 on forced outages due to its inability to staff the units. Dynegy's internal records, however, show that for most of the period, including November 19 and 20, 2000, dates on which the CAISO declared system emergencies, the units were on reserve shutdown. (Ex. CA-9 at 30-31.)

- Dynegy also physically withheld up to an additional 100 MWs or more of generation capacity by simply not placing bids for that capacity even though it was producible. (Ex. CA-5 at 102, Fig. 24.)

- Dynegy engaged in significant "double selling" of energy from ancillary service capacity that was supposed to remain unloaded. (Ex. CA-1 at 8-9; Ex. CA-2 at 156-158 (Table G1).)

- Dynegy cooperated in efforts to cover-up "Ricochet" trades. (Ex. CA-1 at 7; Ex. CA-2 at 87 (Table D-4).)

- Numerous Dynegy traders engaged in false reporting of natural gas prices to trade publications, including in particular Michelle Maria Valencia, who was indicted by the U.S. Attorney for the Southern District of Texas for knowingly transmitting false trade reports and wire fraud. (Ex. No. CA-15 at 12-14.)

- On December 19, 2002, Dynegy settled a civil enforcement action brought by the U.S. Commodity Futures Trading Commission concerning this false reporting. The settlement order found that Dynegy knowingly submitted false information to reporting firms from at least January 2000 through June 2002 in an attempt to skew those indexes for Dynegy's financial benefit. (Ex. No. CA-15 at 13.)

- Dynegy was a subscriber to the Industrial Information Resources (IIR) information service, whereby subscribers obtained current and prospective plant outage data. (Ex. CA-98.)

Mirant

- Throughout the energy crisis, Mirant regularly and systematically exercised market power by withholding (both physically and financially) significant quantities of power from the spot markets. For example, even accepting the forced outages reported by Mirant, which are subject to significant challenge as discussed below, Mirant regularly withheld over 250 MWs of capacity from the market during the Summer and Fall of 2000. (Ex. CA-5 at 16, Fig. 5 & 94, Fig. 21; Ex. CA-7 at 48-63.)

- Mirant financially withheld capacity from the market by regularly bidding certain of its units at far in excess of their marginal cost and the market clearing price and employing non-competitive hockey stick bidding strategies for other units. For example, the average monthly bid prices for Mirant's Potrero Units 4, 5 and 6, closely tracked the prevailing hard caps throughout the May through September 2000 time period. Since Mirant was willing to bid these units at less than $250/MWh during August and September, this confirms that Mirant's average bids of at or above $700/MWh for May and June far exceeded the units' marginal costs. (Ex. CA-7 at 48-49.)

- During the period May through July 2000, Mirant also employed pronounced hockey stick bidding patters for a number of units including, in particular, the Pittsburg units 1 through 7, which regularly had bid spans over $100. In addition, Mirant regularly spiked its bids for certain units particularly during system emergencies. (Ex. CA-7 at 48-63.)

- Mirant physically withheld generation capacity from the market by, among other things, declaring forced outages for certain of its units when in fact the units were operable and could have run above marginal cost. For example, on at least two occasions (October 18-22, 2000 and March 8-21, 2001), Mirant declared forced outages of its Pittsburgh Unit 1 due to tube leaks. With respect to the first occasion,

however, Mirant's internal records show that the unit was on reserve shutdown. (Ex. CA-9 at 23-24.) With respect to the second, the evidence shows that the end of the outage was declared to the CAISO a day later than the end date according to the company's own records and that on this day, March 21st, CAISO had issued a Stage 1 alert. (Ex. CA-9 at 28.)

- Mirant was also one of the most active users of "Fat Boy"-type trading strategies throughout the crisis period. (Ex. CA- 1 at 6-7.)

- Mirant also engaged in significant "double selling" of energy from ancillary service capacity that was supposed to remain unloaded. (Ex. CA-1 at 8-9; Ex. CA-2 at 156-158 (Table G-1).)

Allegheny/Merrill Lynch

- Allegheny/Merrill Lynch were subscribers to the Industrial Information Resources (IIR) information service, whereby subscribers obtained current and prospective plant outage data. (Ex. CA-98.)

Coral

- Coral was one of the four most notable sellers that used the "Death Star" trading strategy throughout the period of crisis. (Ex. CA-1 at 8; Ex. CA-2 at 142-143 (Tables E-1 and E-2).)

- Coral was also one of the primary users of the "Cut Schedule" trading strategy whereby they were paid for fictitious congestion relief. (Ex. CA-1 at 8; Ex. CA-2 at 152-154 (Tables F-1, F-2 and F-3).)

- Coral employed the "Get Shorty" trading strategy during hundreds of hours during the crisis period. (Ex. CA-1 at 8-9.)

- Coral cooperated in efforts to cover-up "Ricochet" trades. (Ex. CA-1 at 7; Ex. CA-2 at 65-66 (Tables D-1 and D-2).)

- In July 2000, Coral entered into a scheduling agreement with Glendale the intent of which included the use of manipulation strategies together including "Get Shorty" and "Death Star" type trades. (Ex. CA-1 at 45.)

- Coral was a subscriber to the Industrial Information Resources (IIR) information service, whereby subscribers obtained current and prospective plant outage data. (Ex. CA-98.)

El Paso

- El Paso has admitted that its traders did provide false information concerning natural gas prices to trade publications, including in particular Todd Geiger, a former Vice President of El Paso Corporation, who was indicted by the U.S. Attorney's Office for the Southern District of Texas for knowingly transmitting a false trade report used to calculate the index prices of natural gas. (Ex. CA-15 at 12-14.)

Morgan Stanley

- Morgan Stanley was one of the four most notable sellers that used the "Death Star" trading strategy throughout the period of crisis. (Ex. CA-1 at 8; Ex. CA-2 at 142-143 (Tables E-1 and E-2).)

- Morgan Stanley as also one of the primary users of the "Cut Schedule" trading strategy whereby they were paid for fictitious congestion relief. (Ex. CA-1 at 8; CA-2 at 152-154 (Tables F-1, F-2 and F-3).)

Sempra

- Sempra Energy Trading ("Sempra"), the trading affiliate of Sempra Energy Resources ("SER"), extensively used many of the manipulative trading strategies made infamous by the Enron Memoranda.

- In fact, Sempra was one of the most predominant users of the "Ricochet" trading strategy whereby power was exported out of California and then sold back into to California. This strategy was used extensively during the period December 2000 through the Spring of 2001 to evade the soft cap. Sempra also cooperated in efforts to make the detection of these trades more difficult. (Ex. CA-1 at 7; Ex. CA-2 at 65-66, 87 (Tables D-1, D-2 and D-4).)

- Sempra was also one of the four most notable sellers that used the "Death Star" trading strategy throughout the period of crisis. (Ex. CA-1 at 8; Ex. CA-2 at 142-143 (Tables E-1 and E-2).)

- Sempra was also one of the primary users of the "Cut Schedule" trading strategy whereby they were paid for fictitious congestion relief. (Ex. CA-1 at 8; CA-2 at 152-154 (Tables F-1, F-2 and F-3).)

- Sempra was also one of the most active users of "Fat Boy"-type trading strategies throughout the crisis period. (Ex. CA-1 at 7-8.)

- Sempra employed the "Get Shorty" trading strategy during hundreds of hours during the crisis period. (Ex. CA-1 at 8.)

- Sempra entered "parking" agreements with Eugene Water and Electric Board and Public Service of New Mexico. (Ex. CA-1 at 119 & Exs. CA-68, CA-69, CA-70, CA-72.)

On such a record, for a seller like Dynegy to now attempt to get the Commission to bless its huge profits under the contract as a form of "scarcity rent" to be paid by California consumers to Dynegy is obscene.

IV. CONCLUSION AND RELIEF REQUESTED.

In sum, the evidence adduced in the 100-Day Proceeding has confirmed what the California Agencies have been asserting all along in the Long Term Contract Proceeding. Sellers within the California spot markets, including in particular, the seven Respondents in that proceeding, during 2000 and the first half of 2001 repeatedly exercised market power by physical and financial withholding of supply, and otherwise manipulated the markets, in order to drive up both spot and forward electricity prices. This wrongful behavior succeeded in inflating the forward prices in the California forward markets during the first five months of 2001 because market participants expected that the dysfunctions pumping up the forward prices in the California markets, most notably the market power and market manipulation, would continue throughout 2001, 2002 and at least part of 2003. These pumped up forward prices in turn form the basis for the unjust and unreasonable prices embedded in the CDWR contracts.

Accordingly, the California Agencies respectfully request that the Commission find that the dysfunctional spot market in California adversely affected the long-term bilateral markets and the effect was of sufficient magnitude to warrant modification of each of the contracts remaining in dispute in the Long Term Contract Proceeding. The

Commission should, therefore, set each of the contracts for consideration as part of Phase II of that docket or, in alternative, remand this matter for further proceedings.

Dated: March 3, 2003

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served copies of the foregoing document upon the parties listed in the attached service list by overnight mail and by the electronic service list for the above captioned proceedings.

Dated: March 3, 2003

/s Jared S. des Rosiers

Jared S. des Rosiers